United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-7272

To be argued by
JOHN M. BURNS, III

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

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RICHARD S. KAYE, :

Plaintiff-Appellant, :

-against- :

FUNDING SYSTEMS CORPORATION, : Docket No. 76-7272

Defendant, :

-and- :

EQUIMARK CORPORATION, :

Defendant-Appellee. :

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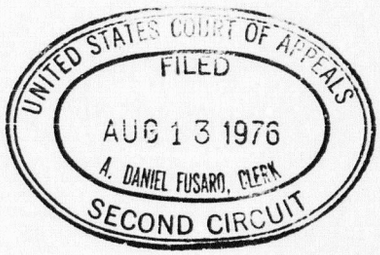

BRIEF ON BEHALF OF
PLAINTIFF-APPELLANT

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TABLE OF CONTENTS

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- -x

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Statement of the Issue Presented for Review

The issue presented for review is:

Whether summary judgment dismissing a complaint and based upon facts exclusively within the knowledge of the moving party may be granted where the court below (a) has denied the responding party any document discovery whatsoever and (b) has curtailed discovery by depositions by limiting the subject matter of the discovery to an issue other than the issue before the court and has denied the responding party

the opportunity to depose the individuals whom the responding party believes to have the most complete knowledge of the facts?

The court below answered this question in the affirmative.

Preliminary Statement

This brief is submitted on behalf of plaintiff-appellant. The appeal is from a decision of Judge Robert L. Carter of the United States District Court for the Southern District of New York and neither the decision nor supporting opinion is reported.

STATEMENT OF THE CASE

The Claims of This Action

The complaint (A-1-14), filed December 20, 1974 (A-vi), and the amended complaint (A-215-230) herein were filed by a shareholder (5,000 [A-53] of approximately 1,093,350 [A-74] shares outstanding) of defendant Funding Systems Corporation ("FSC") initially appearing pro se. As to FSC, the complaint and amended complaint seek only prophylactic relief in the form of fuller reporting to shareholders and the scheduling of a shareholders meeting after the requested disclosure (A-1-10, 14, 215-226, 229-230).

As to defendant Equimark Corporation ("Equimark") the complaint and amended complaint assert that

(a) Equimark unlawfully acquired a 54% controlling interest in FSC in violation of § 4(c)(8)

of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) and § 225.4(b)(2) of Regulation Y (12 C.F.R. 225) promulgated pursuant thereto (A-10-14, 226-229); and

(b) Equimark wrongfully exercised this unlawful control over the affairs of FSC in a manner detrimental to the interests of FSC but in promotion of the interests of Equimark.

The complaint and amended complaint seek judgment against Equimark enjoining it from using the unlawfully acquired control over the affairs of FSC to continue to control the affairs of FSC (A-14, 229-230).

On April 23, 1975 Equimark advised the court that it had disposed of its interests in FSC and that the questions before the court were, therefore, "moot" (A-330-331). After investigation, however, plaintiff became of the opinion that Equimark had disposed of the stock in a manner which permitted it to continue to exercise control over the affairs of FSC in that, at the time Equimark owned the questioned stock it had caused FSC to enter into loan agreements with Equimark which permitted Equimark to control the affairs of FSC and the stock had been transferred to individuals who were substantially involved in the affairs of Equimark (A-391-392, 394). The complaint and amended complaint specifically seek an order restraining Equimark

> "from using its purported ownership of the Unlawfully Acquired Stock * * * to exercise any control over the affairs of FSC" (A-14, 230).

It is plaintiff's position that this language was broad enough to include a claim that Equimark had used its control over the affairs of FSC arising out of its stock ownership to create a situation in which it could continue its control over the affairs of FSC even after disposing of the stock.

The Order Appealed From

The order appealed from (A-536-542) dismissed the complaint for lack of subject matter jurisdiction on the grounds that Equimark had divested itself of the questioned stock and the issue was, therefore, moot. In response to plaintiff's claim that the divesture was a sham transaction under which Equimark retained de facto control over the affairs of FSC, the court below held that plaintiff had failed to present any evidence to establish that the transaction was a sham and had failed to take advantage of discovery opportunities afforded him.

Plaintiff's Efforts to Obtain Discovery

Plaintiff served and filed a notice of deposition and request for production of documents by both defendants on or about February 28, 1975. Contrary to the premise (A-540-541) of the court in issuing the order appealed from, the notice of depositions sought the deposition of officers and employees of FSC having knowledge of the facts (A-234) and also sought depositions of Equimark and two other third parties. The document request was substantial, although it is submitted

that it was relevant to the issues of the action and was well organized to produce material evidence (A-235-247). No one was ever produced for deposition by any of the defendants and no documents were ever produced by any of the defendants. The depositions and document production were repeatedly adjourned, the last adjournment providing for document production on September 22, 1975 with the depositions to commence on September 23, 1975 (A-320-321).

Equimark asserted that the action was moot on April 23, 1975 and plaintiff commenced his investigation to determine whether or not he should continue the action against Equimark. He learned that Equimark has a history of exercising control through nominees of corporations which the Bank Holding Company Act prohibits Equimark from controlling (A-390, 392). He also learned of some of the interrelations between the new purported owners of the FSC stock and Equimark (A-390, 395-398).

As a consequence, plaintiff requested a meeting with the court and the meeting was held on November 15, 1975. At this meeting plaintiff disclosed his suspicions to the court and the court indicated that it would sign an order requiring Equimark to produce for deposition its chairman and chief executive officer, M. A. Cancelliere. After Equimark repeatedly refused to produce Mr. Cancelliere, plaintiff made a formal motion to compel a limited production of the documents previously requested and the production of Mr. Cancelliere for deposition (A-392-393, 322-332).

In response to this motion the court below issued an order (A-355) which denied plaintiff any document discovery of defendants and permitted plaintiff to depose only Robert F. Kastelic, Equimark's executive vice president despite plaintiff's asserted belief that only Mr. Cancelliere was in possession of all of the information which plaintiff desired to obtain (A-351-352). Moreover, the order redefined the issues of the action by stating that the issue before the court "is the validity of the FSC sale of stock". Plaintiff's position was, and still is, that the issue which should have been before the court is whether Equimark had used an unlawful acquisition of FSC stock to obtain and continue control over the affairs of FSC even after the divestiture of the stock. Moreover, this order required plaintiff to complete the discovery in thirty days.

Plaintiff, in a good-faith effort to comply with the order of the court below, took the deposition of Mr. Kastelic within the time provided, and the deposition proved to be as useless as plaintiff had predicted because:

(a) Mr. Kastelic was aware that FSC owed Equimark or its subsidiaries a total of $20,922,000 in December of 1975 (A-465). Obviously, the terms of the loan documents governing these loans, which had been incurred at the time that Equimark owned a majority interest in FSC, could be sources of control over the business affairs of FSC. Mr. Kastelic was aware that changes had been made in the terms of the loan documents

during 1975 (A-486) but he was not familiar with these changes (A-487). He also was aware that there were changes in the terms of the loan documents in 1976 (A-487) but he was not familiar with these changes (A-488). He knew that FSC owed more than $5,000,000 to other banks (A-468) but he did not testify as to what had happened in respect of these particular loans.

(b) Equimark's counsel would not permit Mr. Kastelic to testify as to the existence of any loans by Equimark or any of its subsidiaries to Mr. Garland* or the law firm of which he is a member (A-499), to Mr. Ganassi* (A-499-500) or to any corporation to which Mr. Garland or Mr. Ganassi formed a part of the management group (A-501-502). Obviously, if such loans exist, they could be a source of control over Messrs. Garland and Ganassi who are the new owners of the majority of the stock of FSC.

(c) Mr. Kastelic did not know whether Mr. Garland or Mr. Ganassi were shareholders in Equimark (A-494). FSC's Proxy Statement dated October 22, 1975 asserts that Mr. Garland owns 6,100 shares of common stock of Equimark (more, apparently, than any director of Equimark other than M. A. Cancelliere). Hence, Mr. Garland is, at least, a friendly hand in which to place the FSC stock.

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* Messrs. Garland and Ganassi are the new purported owners of the subject FSC stock.

(d) Plaintiff was in possession of information to the effect that the law firm of which Mr. Garland is a member had on some occasions represented Equimark or its subsidiaries. Mr. Kastelic testified that he knew that Mr. Garland's law firm had represented Equibank in connection with two loans and that he would not know all such representations (A-497-498) and he did not testify as to the nature and extent of that representation. The house counsel to Equibank, who would have been familiar with these matters, was present at this deposition but Equimark refused to permit him to testify (A-504). Papers in three separate lawsuits involving over $1,500,000 of claims (A-512-529) and a demand letter (A-530) establish that Mr. Garland's law firm's representation of Equibank is substantial. Equimark's counsel refused to permit Mr. Kastelic to testify as to whether or not Mr. Garland or his law firm had ever represented Equimark's chairman and chief executive officer, M. A. Cancelliere. It is obvious that legal representations of this type could afford Equimark continuing control over Mr. Garland's operation of FSC and, in fact, could suggest that Mr. Garland is nothing more than a nominee of Equimark in holding the FSC shares, for this would not be an unusual role for an attorney.

(e) Plaintiff desired to explore the determination of the price paid by Messrs. Garland and Ganassi for the

FSC stock because it would be possible to infer, had the stock been sold for an exceedingly low price, that retention of some form of control by Equimark could have resulted in a lower purchase price. Thus, it was relevant to inquire as to Equimark's efforts to sell the stock prior to determining to sell it to Messrs. Garland and Ganassi. Although Mr. Kastelic was charged with the duty of selling the stock as early as 1974 (A-443-444, 447-449), he could not specifically recall whom he contacted as potential purchasers (A-444-445, 451). As of December 13, 1973, there was pending an offer to purchase the FSC stock from Equimark at an price of $3.00 per share (see Exhibit "5" [A-531]), but Mr. Kastelic testified that he did not ever contact the offerers (A-456-460) and he could not recall if anyone else at Equimark had contacted them (A-462). In any event, he started his negotiations with Messrs. Garland and Ganassi by offering the stock at $1.00 per share (A-465) and they paid $.55 per share.

(f) Mr. Kastelic was not sure whether he and the other Equimark representatives on FSC's board of directors resigned before or after sale of the stock which occurred on April 22, 1975 (A-489-491) and he did not know whether he had attended a board meeting after that sale (A-491-492) and he had nothing with him to refresh his recollection.

(g) Prior to their purported purchase of Equimark's FSC stock, Messrs. Garland and Ganassi were elected as

the major officers of FSC. Mr. Kastelic could not remember that board meeting (A-424) or any of the discussions related to the decision to elect Messrs. Garland and Ganassi as officers of FSC (A-426-430) and he had nothing present to refresh his recollection. Obviously, Messrs. Garland and Ganassi were installed as officers of FSC to carry out the wishes of Equimark, and the practices established during this period could have been intended to have been carried over into the time period in which Garland and Ganassi are the purported owners of the FSC stock.

(h) Mr. Kastelic did not know whether Mr. Cancelliere owns any stock in any companies of which Messrs. Garland and Ganassi are part of the management (A-503).

ARGUMENT

HAVING DENIED PLAINTIFF AN OPPORTUNITY FOR FULL DISCOVERY OF FACTS EXCLUSIVELY IN DEFENDANTS' CONTROL, THE COURT BELOW SHOULD NOT HAVE DISMISSED THE COMPLAINT ON DEFENDANTS' BALD ASSERTION THAT THEY HAD MOOTED THE ACTION.

It is obvious that plaintiff faces unusual difficulty in meeting his burden of proof in this action. Most facts are exclusively in the possession of individuals associated with defendants and having strong interests not to disclose them. Proof will depend largely upon inferences drawn by the trier of fact from facts that plaintiff will be able to establish. The fact that plaintiff faces difficulties, however, should not persuade the court to deny plaintiff dis-

covery; this fact should have persuaded the court to afford plaintiff broader discovery opportunities.

Nevertheless, the court below denied plaintiff any opportunity for document discovery. Moreover, the court below limited discovery to an issue which was not the actual issue in the action and at the only deposition permitted by the court, defendants' counsel took advantage of this regretable limitation to curtail and prevent testimony. The court below also denied plaintiff the opportunity to have discovery of the individual whom plaintiff believes to have the greatest knowledge of the relevant facts. The court then dismissed the complaint because plaintiff could not produce evidence to support the complaint.

Under these circumstances, the complaint should not have been dismissed, plaintiff should have been permitted complete discovery and the order appealed from should be reversed. Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Circ. 1968); Robinson v. Penn Central Co., 58 F.R.D. 436 (S.D.N.Y. 1973). See also Loeb v. Whittaker Corp., 33 F.Supp. 484, 487 (S.D.N.Y. 1971).

In the Schoenbaum case, supra, this Court stated the rule which governs the present motion as follows:

> "The district court's grant of summary judgment against the plaintiff was accompanied by a refusal of his request for discovery. This court has indicated that summary judgment should rarely be granted against a plaintiff in a stockholder's derivative action especially when the plaintiff has not had an opportunity to resort to discovery procedures. [Citations omitted.] The plaintiff typically has in his possession only the facts

> which he alleges in his complaint. Having little or no familiarity with the internal affairs of the corporation, he is faced with affidavits setting forth in great detail management's version of what actions were taken and what motives led the affiants to take these actions. Since the facts in such a case are exclusively in the possession of the defendants, summary judgment should not ordinarily be granted where the facts alleged by the plaintiff provide a ground for recovery, at least not without allowing discovery in order to provide plaintiff the possibility of counteracting the effect of defendants' affidavits." 405 F.2d at 218.

Similarly in the Robinson case, supra, Judge Lasker stated the rule governing the present motion as follows:

> "The Court of Appeals of this Circuit has made it clear that summary judgment should be sparingly granted in securities fraud cases when little or no discovery has been completed and when, as is the case here, the defendants have exclusive possession of the facts. [Citations omitted.] Plaintiff is entitled to an opportunity to discover the knowledge, actual or constructive, of O'Neill at the time he executed the sales and whether O'Neill had a duty to the plaintiff to inquire as to the circumstances surrounding Chase's orders." 58 F.R.D. at 440.

CONCLUSION

For the foregoing reasons, the order appealed from should be reversed in its entirety.

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